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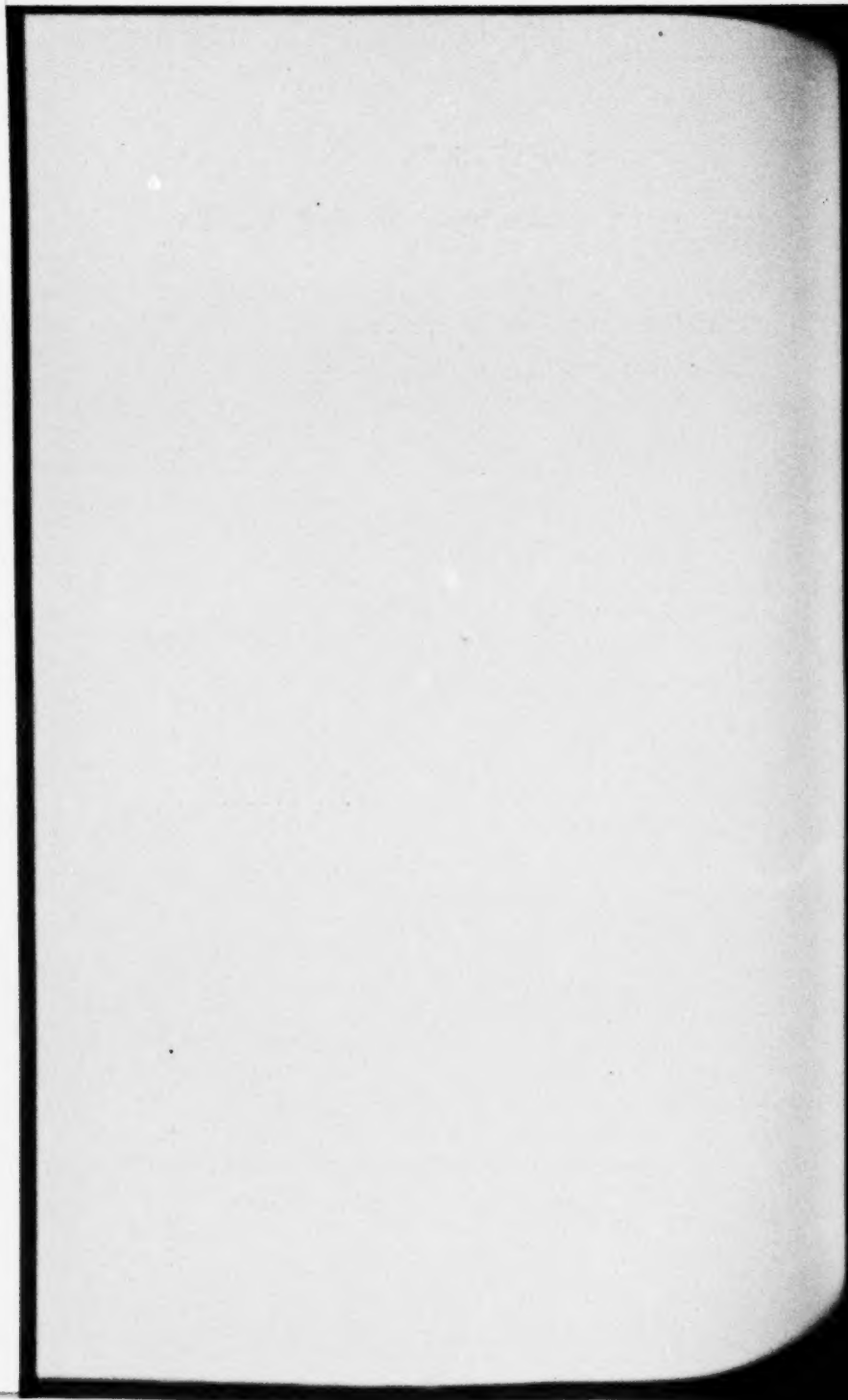

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

LEWIS L. STRAUSS,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 288

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF IN SUPPORT OF THE PETITION

1. The Findings of the Tax Court on the Basic Factual Issue Are Conclusive.

The brief for the respondent in opposition to the petition for certiorari does not attempt to meet the basic issue in this case other than to call it a "technical" one (Br. 10). That basic issue is the factual one of whether the petitioner's compensation was (1) the receipt by him of an "interest in the Kodachrome process of manufacturing color film", i.e. an interest in an invention, or (2) the receipt of a percentage of the royalties paid upon that interest.

That basic factual issue was decided adversely to the respondent by the Tax Court when it found that "the petitioner was the owner of an interest in the Kodachrome process" (R. 19);* and that the "petitioner acquired ownership of such interest in consideration for and in full payment of his services to New York and Foreign Development Corporation" (R. 28). The Tax Court further found that the petitioner was paid for his services "by the vesting in him of ownership of an interest in the Kodachrome process" and that the royalties paid upon that interest, which was "an income-producing asset", were "not compensation for services rendered by petitioner" (R. 31).

The Court of Appeals for the Second Circuit made a different determination of that basic factual question and stated that the petitioner was "paid for his services a definite portion of the royalties" (R. 64), thereby reversing the Tax Court upon its determination of the basic factual question in the case. The statement by the respondent (Br. 5) that the Court of Appeals merely disregarded "the label attached by the Tax Court" is both unfair and misleading. Nor is the distinction merely a "technical" one. It is the basic issue in the case. If the receipt of the interest in the Kodachrome process was itself the petitioner's compensation (rather than the royalties to be received thereon) then the assignment of that interest to the petitioner's wife was not the assignment of compensation to be received in the

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*We repeat what we said in our opening brief (p. 12) that *on the record in this case* the petitioner was the only person who had "an interest in the Kodachrome process" (the invention) in 1935. Others may have had interests in the royalties, as the respondent states (Br. 7n), but the petitioner is the only person who was admittedly the owner of an interest in the invention itself at that time.

future, with which this Court was concerned in *Lucas* v. *Earl*, 281 U. S. 111, and *Helvering* v. *Eubank*, 311 U. S. 122, but merely the assignment of an interest *already received as compensation.*

Moreover, the very finding of fact which the Tax Court made in this case was considered basic by this Court in *Commissioner* v. *Smith*, 324 U. S. 177, 695, cited by the respondent (Br. 10). In that case, an employer had given an employee an option to purchase stock at the market value of such stock at the time the option was given in what was admittedly a compensatory arrangement. The employee later exercised the option and at that time the employer transferred to him stock which was worth much more than the price which the employee paid for it. If the receipt of the option itself was considered to be the receipt of compensation, then the employee would not have been taxable, as the year in which the option was received was not before the Court. If, however, the compensation was intended to take place only when the employee exercised the option and received property worth more than he paid for it, the employee would be taxable upon a large amount of income. As this Court said (p. 182), the Tax Court found "that the compensation referred to was the excess in value of the shares of stock over the option price whenever the option was exercised".* Indeed, it would have been difficult in that case for the Tax Court to have found otherwise. The employer obviously did not discharge its obligation to the

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*This Court again emphasized the above finding of the Tax Court in its opinion on rehearing (324 U. S. 695), saying:

> "The Tax Court found that respondent received compensation 'when [he] exercised his option and received the stock'. * * * This conclusion of the Tax Court finds ample support in the record and we concur in it."

employee by merely giving him the option; it could discharge its obligation only by delivering the stock to him at some later date when the option was exercised.

So also in *Helvering* v. *Eubank,* 311 U. S. 122, *supra,* it was not found by the Tax Court, nor could it have been found, that the employer paid the employee compensation by merely giving him a contract to pay him future commissions. The employer's obligation was discharged and the employee received compensation only as the employer paid the commissions pursuant to that contract.

In the instant case, however, the Tax Court has found that the petitioner received his compensation prior to the years here in question (1938 and 1939) by being given "an interest in the Kodachrome process of manufacturing color film". The Tax Court has found explicitly that it was the vesting in the petitioner of that interest (a valuable attribute of which was of course the *right to receive* royalties) which was the compensation for the petitioner's services, and not the royalties themselves.

The record contains ample support for the Tax Court's findings. It was not stipulated that the petitioner's interest in the Kodachrome process consisted "only" of his right to receive royalties, although the respondent's brief contains that implication (Br. 2, 6, 8), and the Tax Court certainly did not so find. Neither is it stipulated that the royalties were the petitioner's compensation, but rather that his compensation was being "*entitled* to receive" such royalties (R. 40). The Tax Court's finding that he was "entitled to receive" such royalties by reason of having been given "an interest in the Kodachrome process" is the only reasonable finding that could be made in view of the admissions on the pleadings that the petitioner was the owner of an "interest

in the Kodachrome process" (R. 6, 15) and that the royalties received by his wife were "royalties paid upon said interest in the Kodachrome process" (R. 6-7, 15).*

The Court of Appeals states in its opinion, however, that it "now appears that the 'interest' was only the right to receive a percentage of the royalties" (R. 63). The Court's use of the word "now" clearly shows that it was substituting its finding for that of the Tax Court. Even if the finding of the Court of Appeals were as reasonable an inference from the record as that of the Tax Court (which it clearly was not) it would still be improper and an abuse of its power of appellate review. The Court of Appeals, by so substituting its own finding of fact for that of the Tax Court, disregarded the rule of appellate review so clearly laid down by this Court in *Commissioner* v. *Scottish American Investment Co. Ltd.*, 323 U. S. 119, 123-124:

> "* * * The Tax Court has the primary function of finding the facts in tax disputes, weighing the evidence, and choosing from among conflicting factual inferences and conclusions those which it considers most reasonable. The Circuit Courts of Appeal have no power to change or add to those findings of fact or to reweigh the evidence. And when the Tax Court's factual inferences and con-

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*The respondent (Br. 7) apparently attributes great weight to the fact that the petitioner notified Kuhn, Loeb & Co. (the trustees to whom the *royalties payable* by Eastman on the Kodachrome process had been assigned by the inventors in 1930) of the assignment of his interest to his wife. As the trustees paid out *all* the percentage royalties on the process (R. 40), any owner of an interest in the invention who assigned his interest to another would necessarily have to notify the trustees so that the assignee of his interest could receive the royalties to which the ownership of that interest entitled him.

> clusions are determinative of compliance with statutory requirements, the appellate courts are limited to a determination of whether they have any substantial basis in the evidence. The judicial eye must not in the first instance rove about searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable. It must be cast directly and primarily upon the evidence in support of those made by the Tax Court. If a substantial basis is lacking the appellate court may then indulge in making its own inferences and conclusions or it may remand the case to the Tax Court for further appropriate proceedings. But if such a basis is present the process of judicial review is at an end. * * *"

That the facts were stipulated or undisputed does not change the rule. As this Court recently said in *Boehm* v. *Commissioner*, 326 U. S. 287, 293:

> "The circumstance that the facts in a particular case may be stipulated or undisputed does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts."

Nor is the respondent correct in implying (Br. 8) that the petitioner must meet the burden of proving that the Tax Court's finding was the only possible construction of the record. The Tax Court's finding is conclusive if it is supported by substantial evidence, even though the appellate court might also find evidence to support its view (which here it could not). *Helvering* v. *F. & R. Lazarus & Co., Inc.*, 308 U. S. 252; *Choate* v. *Commissioner*, 324 U. S. 1.

The findings of the Tax Court, that (1) it was the giving to the petitioner of his "interest" in the invention (which included the "right to receive" the royalties) which constituted the petitioner's compensation, and (2) that the royalties themselves when later received were not the petitioner's compensation, are amply supported by the pleadings and by the stipulation.*

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*The respondent states (Br. 10-11) that a taxpayer, on the cash basis, who acquires a contract to receive future payments is not taxed when he receives the contract, but only later when he receives the payments. That statement cannot be made seriously, as the respondent has so frequently successfully contended to the contrary.

To take one example, suppose that an employer gives an employee, age 40, an annuity policy under which the employee is to receive payments from an insurance company beginning at age 65. The question is whether the employee's compensation arises from the receipt of the policy or from the receipt of later payments pursuant to the policy. It appears well settled that the compensation arises upon the receipt of the annuity contract. *Oberwinder* v. *Commissioner*, 147 F. (2d) 255 (C. C. A. 8th); *Hubbell* v. *Commissioner*, 150 F. (2d) 516 (C. C. A. 6th); *Hackett* v. *Commissioner*, 159 F. (2d) 121 (C. C. A. 1st); *Ward* v. *Commissioner*, 159 F. (2d) 502 (C. C. A. 2d).

2. There is a Conflict Between the Decision Below and *Nelson* v. *Ferguson* (C. C. A. 3rd).

We do not follow the respondent's statement that there is no conflict between the decision of the Court of Appeals in this case and *Nelson* v. *Ferguson,* 56 F. (2d) 121 (C. C. A. 3rd) cert. den. 286 U. S. 565. The respondent states that "the right to receive royalties there did not represent compensation" (Br. 11). The respondent's position is inconsistent with the position taken by the Government in that case and with the theory on which that case was decided. In the *Nelson* case, the royalty payments were paid to the taxpayer's wife by his employer pursuant to a royalty contract which he had assigned to his wife; the Government argued that the case was "squarely ruled by" *Lucas* v. *Earl,* 281 U. S. 111, *supra,* (which involved the assignment of compensation); and the Court (as did the Tax Court in the instant case) distinguished the *Earl* case upon the ground that the royalties themselves were earnings from income-producing property, rather than compensation, saying (p. 125):

> "Here the income sprang from assigned property and, if validly assigned, the income was that of the assignee, the owner of the property and was taxable as hers."

CONCLUSION

It is accordingly submitted that this Court should issue a writ of certiorari to review the decision of the Court of Appeals in this case.

(1) The Court of Appeals has exceeded its power of appellate review, as clearly limited by decisions of this Court.

(2) The decision below is in conflict with a decision of the Third Circuit Court of Appeals on the same matter.

(3) This case presents an important question of Federal law which should be settled by this Court.

Respectfully submitted,

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November 3, 1948.